



CITY MANAGER'S 6-POINT PLAN OF ACTION

Point 5: Potential Fee, Charge and Tax Increases

POINT 5: POTENTIAL FEE, CHARGE AND TAX INCREASES

EXECUTIVE SUMMARY

This report is the last in a series of planned special reports that have been presented on the specific budget strategies described in the City Manager's 6-Point Plan of Action to the City's budget crisis. The five previous points focused on ways to reduce the cost of delivering City services. The recommended cost savings to date are estimated to be \$13.6* million of the projected \$15 million expenditure to revenue gap in the General Fund. In order to fully close the remaining gap of \$1.4 million, and to ensure ongoing structural balance, Council will need to raise additional revenue, or consider additional expenditure reductions.

Efforts to increase revenues in response to the budget crisis can be achieved through three principal means:

- First, separate and apart from this report, Council will consider increases to the Fee Schedule as part of the FY 2003/2004 Recommended Budget. At that time Council will also consider several new proposed fees (some of which will be introduced here). These new fees will be presented as a way of recovering costs associated with provision of *existing* services.
- Second, several proposed fees to recover costs of providing *existing* services are discussed in this report that will *require policy direction from Council*. If it is the Council's pleasure, these potential new fees could conceivably be adopted during the upcoming fiscal year, following further analysis and discussion.
- Third, Council can consider increasing or modifying existing taxes, or enacting new taxes.

It is important to note at the outset that, with the exception of the new fees proposed with the FY 2003/2004 Recommended Budget, many of the *revenue generation* options presented here require thorough analysis and discussion beyond the scope of this report. Further, the information contained in this report is not meant to encompass every revenue-raising option available to the Council. If it is the Council's pleasure, staff can research and present additional options, or more vigorously pursue any of the information contained herein.

*Staff continues to review and verify the expense reductions that can be generated by the recommended changes to services and service levels. Staff has found that the recommended service reduction for the Public Safety Department did not include a reduction in hours for two positions that amount to an additional \$217,238 in salary and benefits that can contribute to closing the General Fund gap.

It is also important to note that the processes/requirements to enact or increase fees/charges and those to enact, modify or increase taxes are completely separate, the main difference being that taxes require voter approval. In addition, many complex procedural and substantive requirements found in State law have evolved over time, making it increasingly difficult for local governments to raise new revenue. There are some *twenty* State Propositions alone (not to mention dozens of pieces of legislation) that have been enacted *since* Proposition 13 in 1978 that impact how municipal revenues are raised and expended. Many of these are now codified in the State Constitution/Statutes.

As the Council begins to focus on new revenue generation ideas, it is vital to consider all stakeholders, especially Sunnyvale residents and businesses, and the relative palatability of new or increased taxes to them. To that end it would be prudent to not only consider as few tax measures as possible, but also to involve as many stakeholders *as early as possible in the process* if new tax measures are to be successful. One more key point to consider centers around the fact that *some of the tax measure options* presented here will require a 2/3 vote to enact (rather than a simple majority), which can be extremely difficult to achieve.

Several of the *fee options* discussed in this report were included in the Department Budget Reduction proposals submitted to Council on April 18, 2003, and thus have already been counted toward the revenue to expense gap. Other fee options, should Council decide to pursue them, can be counted towards the estimated gap of \$1.4 million. The fee options included in the FY 2003/2004 Recommended Budget, if approved by Council, will take effect on July 1, 2003. The fee options requiring policy direction can potentially be enacted by January 1, 2004, pending Council approval.

At this time staff has identified approximately \$1,426,000 in proposed fee revenue to count towards the gap. This is a preliminary total for the increased revenues from fees and charges that can be changed through Council action without voter approval. Attachment A identifies those fees that have previously been counted in the \$8.6* million service reduction recommendation and those that are new revenue.

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BACKGROUND

This section briefly describes Sunnyvale's revenue streams, provides a general overview of the municipal revenue-raising authority of charter cities, highlights the major distinctions between fees/charges and taxes, and discusses the major State laws governing municipal taxes.

Sunnyvale's Revenue Streams

In basic terms, Sunnyvale's revenue is generated in two ways: it is either collected directly by the City, or it is collected on our behalf and apportioned to us. The revenue collected by the City consists of fees/charges, along with certain local taxes. The revenue collected on our behalf and apportioned to us comes from other governmental entities, chiefly the State and the County (on behalf of the State) and in general consists of taxes, the rates of which are set by the State. Examples of these revenue sources are the Property Tax, Sales and Use Tax, and the Vehicle License Fees. This distinction will be further explained in the sub-sections below.

Municipal Revenue Generation and Authority

California cities may raise revenues through 1) enactment of taxes and 2) imposition of user fees/charges designed to recover reasonable costs of providing a particular service. California cities typically fall into two categories: Charter cities or General Law cities. With General Law cities, the power to tax is derived from a grant of authorization by the Legislature, while a Charter city's power to tax is limited only by its Charter and by the State law that has occupied the field in a given area of taxation. This distinction does not necessarily give an advantage to Charter cities, in large part due to the continued erosion of local government revenue raising authority. As Sunnyvale is a Charter city, this report focuses exclusively on revenue raising requirements specific to this city type.

Local Fees and Charges¹

As a general rule, fees and charges can generally be enacted or increased through administrative action such as ordinance or resolution adoption, and approved by *majority vote* of the City Council. The general authority to impose fees, also called charges or rates, can be found in Article XI of the State Constitution. Fees differ from taxes in two important ways:

¹ League of California Cities, Municipal Revenue Sources Handbook, 2001 Edition.

1. The amount of the fee may not exceed the estimated reasonable cost of providing the particular service or facility for which the fee is charged (taxes *generally* have no such restriction).
2. The service or facility for which the fee is charged bears a relationship to the person or entity paying the fee.

Fees and charges typically fall into three broad categories:

- User Fees – Charged to persons or entities that use or consume a City service. In addition, Proposition 218 established a subset of user fees consisting of property-related fees imposed to fund property-related services.
- Development Fees – Charged to persons or entities for the privilege of developing private property to defray the cost of public facility and service provision.
- Regulatory Fees – Charged to businesses to pay for services established to mitigate the deleterious effects of the enterprises on the community.

The other major type of local charge for service is in the form of Utility Rates. Such charges fund the operation, maintenance, repair and management of revenue-producing enterprises such as water, sewer, transit systems, or other utilities. At the regularly scheduled meeting of April 22, 2003, the Council approved an average rate increase of 7% for Sunnyvale utilities.

Conversely, new taxes and modifications or increases to existing taxes require voter approval. In addition, the requirements for adopting new taxes set forth in State law are much more stringent, and have become increasingly complex over the last three decades.

State Laws Affecting Local Taxes

Over time the relative ability of cities to levy taxes has been restricted through the passage of state laws, most notably the voter-approved initiatives of Proposition 13 in 1978, Proposition 62 in 1986, and Proposition 218 in 1996. While many other state laws have been enacted that impact local government revenue raising authority, these three initiatives have produced the most substantive changes relative to new tax levies. One of the most significant developments in the law of local taxation since the adoption of Proposition 13 was the California Supreme Court's determination that Proposition 13 allowed the State Legislature to allocate and distribute the property tax. The court's decision

transformed what was considered a local tax into a state-administered tax.² The Vehicle License Fee is another example of a previously locally collected tax that is now state-administered.

Differences Between General and Special Taxes

The passage of Propositions 13, 62 and 218 created important distinctions between types of taxes, established the voter approval requirements needed to enact such taxes, and imposed additional procedural requirements. The first major change created the distinction between **general** and **special** taxes. Since 1978, all local taxes fall into either one of these categories. A general tax refers to any tax imposed for general governmental purposes. Some examples of this tax include Sales and Use Tax, Property Tax, Transient Occupancy Tax and Utility Users Tax. General taxes will be treated as *special taxes* if earmarked for a specific use.

A special tax is any tax imposed for specific purposes. Examples of special taxes include Benefit Assessments, Special Tax for Library or Public Safety Services, Paramedic Taxes, Parcel Taxes, and Mello-Roos Community Facilities Districts. A more complete description of special taxes is given in the section of this report entitled "POTENTIAL NEW TAXES."

Voter Requirements for General and Special Taxes

The distinction between general and special taxes also created specific voter requirements needed to enact either type of tax. To enact a general tax, a majority vote (50.1%) is required. The vote on general taxes *must* be consolidated with a regularly scheduled general election of city councilmembers. The council election requirement may be suspended in emergency situations declared by a unanimous vote of the city council, although this has rarely justifiably occurred. Most of Sunnyvale's existing taxes are general taxes, including the Property Tax, Sales Tax, Business License Tax, Construction Tax, Transient Occupancy Tax, and the Utility Users Tax.

To enact a special tax, a super-majority or two-thirds vote (66.8%) is required. The vote on a special tax may be held either in conjunction with or outside of the regular council general election process at a *special election*.

Should the Council wish to pursue a ballot measure to increase or modify existing general taxes, or to enact a new *general tax*, the measure

² League of California Cities, Municipal Revenue Sources Handbook, 2001 Edition.

would have to be submitted to the voters in November of an odd-numbered year, such as 2003 or 2005. Alternatively, if a *special tax* is pursued, the opportunities increase to include any established election date (every March, every November, April in even-numbered years, June in odd-numbered years).

Below is a summary table of the approval requirements for local taxes and fees/charges:

<u>Approval Requirements for Local Revenues³</u>		
<u>Revenue Type</u>	<u>Governing Body Approval</u>	<u>Voter Approval</u>
• General Taxes	• Majority	• Majority
• Special Taxes	• Majority	• 2/3
• School or Special District Taxes	• Majority	• 2/3
• Property Assessments	• Majority	• Majority of affected property owners
• Property-Related Fees	• Majority	• 2/3 of voters or majority of affected property owners ⁴
• Fees – All Other	• Majority	• None

PROPOSED FEES AND CHARGES

This section outlines the new fees being proposed with the FY 2003/2004 Recommended Budget, and discusses potential new fees that will require policy direction from the Council in order to implement. Where available, the estimated cost recovery generated by fee increases will be given.

New Fees and Charges Recommended for FY 2003/2004

As part of the ongoing review of current practices in light of the City’s significant fiscal challenges, staff will be proposing a number of new fees for Council consideration as part of the existing Fee Schedule with the FY 2003/2004 Recommended Budget. The fees are being presented as an allowable means to recover full cost of providing *existing* services, and are discussed here so that Council is provided the information in advance.

³ Does not include General Obligation Bonds or other debt instruments.

⁴ No vote required for gas, electric, water, sewer, refuse or developer *property-related fees*.

Business License Processing Fee

One option Council will be considering with the Recommended FY 2003/2004 Budget is a Business License Processing Fee. This fee has also been submitted to Council as part of the Finance Department's Budget Reduction package.

Staff will be recommending a \$25 processing fee for new applications and \$10 for processing renewals. The fee for new applications is expected to generate \$34,000 in revenue and the fee for renewals is estimated to generate \$71,000 for a total of \$105,000. Having performed a time and motion study to estimate the cost of processing business license applications and renewals, staff feels that the proposed fees can recover some of the costs involved in processing business licenses.

The key point is that the Business License Tax (BLT) was enacted to raise revenue. As the costs to process licenses and administer the tax increased over time, the tax itself was never raised and the revenue generation potential has been eroded. Enacting a processing fee will allow the City to recoup some of this loss without triggering a Prop 218 election. The revenue generated by a Business License Processing Fee is estimated to be \$105,000.

Community Planning Fee – General Plan Maintenance

During their 2002 session, the State Legislature enacted AB 2936 (Aroner), which clarifies that local governments have the authority to use permit processing fees to cover the necessary costs to prepare and revise General Plans. The proposed General Plan Maintenance Fee would be assessed as 0.05% of the total value of construction work for which a permit is required pursuant to Chapter 16.12 of the Sunnyvale Municipal Code. Based on the FY 2002/2003 valuation, the proposed fee would generate approximately \$75,000.

This proposed fee was also included in the Community Development Department's Budget Reduction proposal.

DVD/Video Rentals at Library

Over the past year, the Library expanded its popular collection of VHS feature movies to include DVDs, largely driven by customer demand and the increasing availability of material. Though standard practice recommends against charging the public for information in one format over another, cost recovery of providing this popular service is more desirable than eliminating this service or some other service altogether.

It is anticipated by the Library that enacting a rental fee may discourage some current users from accessing the service, but this will likely be offset by new users who will be attracted to the growing collection rich in quality films which reflect the diversity of the community and the best offerings in cinematic art.

The rental project would begin in FY 2004/2005. Some new equipment and minor construction will be necessary in FY 2003/2004. The proposed fee would be assessed at \$1.50 for 3 days. Based on an estimated 273,000 rentals per year, the fee would generate about \$300,000 in revenue and would recover around 94% of the costs. These costs include additional staff costs of \$100,000 per year needed to maintain the materials through a process where actual films are shelved in a secure area while empty boxes are shelved in the public area. The need for staff time will decrease if the circulation is lower than anticipated, lowering the cost of the service.

This proposed fee was included in the Library's Budget Reduction package.

False Fire Alarm Fees

A number of California cities have implemented a False Fire Alarm Fee to recover the considerable cost associated with responding to such occurrences. Currently Sunnyvale assesses a fee for false *burglar* alarms, but not for false *fire* alarms.

The City's Fire Prevention staff handles more than 1,200 false fire alarms every year. Responding to these alarms requires significant staff time and *negatively influences the overall safety of the community by diverting public safety officers from actual emergencies.* Although it is difficult to measure the full cost of responding to false fire alarms, e.g., any overtime generated, dispatching costs, level of staff response required, etc., a False Fire Alarm Fee can recover some of the costs, and more importantly, *discourage unchecked false fire alarms.*

Several cities in the Bay Area were surveyed to determine who charges a fee for false fire alarms. While Palo Alto, Cupertino, San Jose, Mountain View and Fremont do not currently assess the fee, the cities of Santa Clara, San Mateo and Redwood City do. Those cities surveyed who currently charge the fee are listed in the table below.

City	# of Free False Fire Alarms	Fees
Santa Clara	2 free; penalty for 3 rd in 30-day period	3 rd and subsequent \$150 per occurrence
San Mateo	None	\$240 each occurrence
Redwood City	2 free; penalty after 3 rd in 12-month period	3 rd and subsequent \$375 per occurrence

The Department of Public Safety currently charges a False Burglar Alarm Fee and is proposing an increase to the fee with the FY 2003/2004 Recommended Budget, at the same amount and penalty listed below.

Sunnyvale – <u>Proposed</u>	2 free; penalty for 3 rd in 12-month period	\$150 for 3 rd and each additional
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Since the fee is only charged on the third and subsequent alarm in a one-year period, it is difficult to estimate annual revenue. However, assuming that 50% of the calls are subject to the fee, new annual revenue would be at least \$100,000.

New Fees/Charges Requiring Policy Direction

The following fees represent potential revenue opportunities designed to recover the reasonable costs associated with acquiring, operating, maintaining and improving *existing* City-provided services and systems. The fees described below may be enacted through ordinance or resolution and adopted by a majority vote of the Council at any time, provided all reasonable cost recovery estimates have been thoroughly researched by staff.

These fees are currently not scheduled to be presented with the FY 2003/2004 Recommended Budget because they require policy direction from the Council, or further research. Council may wish to pursue one or more of these fees in light of the current budget situation. Such fees could potentially be adopted during FY 2003/2004 if the Council so chooses, or adopted at any time thereafter.

Emergency 911 Fee

Emergency 911 Fees are designed to recover the reasonable costs associated with acquiring, operating, maintaining and improving the 911-emergency communications system operated by a city or county. The fee currently is used by only two jurisdictions in this area. In general, this fee consists of a small monthly charge to telephone subscribers, based on the justification that telephone service subscribers

derive a significant benefit from the operation and maintenance of the emergency communications system. The fee is assessed as a monthly charge on telephone access or trunk lines. The service supplier then collects the fee and remits it to the City.

In the Bay Area, the City and County of San Francisco has successfully implemented this fee, while the County of Santa Cruz is experiencing difficulty with implementation. It is expected that San Jose will impose this type of fee in the near future. The principal issue Santa Cruz is facing centers around the assertion by service providers that the charge is a tax, not a fee, and requires voter approval. Interestingly, Santa Cruz patterned its ordinance on the San Francisco model. Though not confirmed, it appears that San Francisco's relative success (and Santa Cruz' relative difficulty) in compliance may be due to two factors: 1) open, up-front communications with the service suppliers in advance of enacting the fee, and 2) accurate and well-documented expenses for emergency 911 service provision to fully justify cost recovery.

Staff is currently working to identify which charges our Public Safety Department could recover through imposition of such a fee. We will also be reviewing options for structure of the fee. Results of this analysis will be brought back to the Council if you wish to pursue this option. It is anticipated that this revenue source will generate \$250,000 annually.

Homeowner Sidewalk Repair Fee

According to provisions of the California Streets and Highways Code, property owners are responsible for maintaining the sidewalks, park strip areas and curbs & gutters fronting their property. Maintenance responsibility includes, but is not limited to, repair or replacement of damaged or displaced concrete, abatement of weeds or debris, and the trimming of trees and shrubs. If property owners refuse to pay the fee, State law allows local governments to assess liens on the parcels through the County property tax rolls.

A number of California cities, including San Jose, Redwood City and Gilroy, have implemented some type of Sidewalk Repair Fee. Of the cities surveyed, cost recovery ranges from 50% to 100%, including administrative costs, and some cities provide rebate programs to reimburse certain owner-repair costs.

Currently Sunnyvale *absorbs all costs associated with sidewalk, park strip and curb & gutter repair*, though by State law we may pass on these costs to property owners. It is currently estimated that the full cost of sidewalk repair to Sunnyvale is approximately \$700,000 annually.

A proposal that would recover 50%, or about \$345,000 of sidewalk repair costs has been forwarded to Council as part of the Public Works Department's Budget Reduction package. This proposal would require amendment of the Sunnyvale Municipal Code. Upon Council approval of the concept, staff from Public Works and the Office of the City Attorney will begin working to put this fee in place by January 1, 2004.

Trench Cut Fees

A number of California cities have implemented Trench Cut Fees to recover the reasonable costs associated with resurfacing, maintaining and repairing paved streets that have been degraded by trench cutting. The City currently requires a permit for street (trench) cutting, but assesses no Trench Cut Fee. Studies have amply shown that trench cuts degrade and shorten the life of streets even if subsequent pavement restoration is structurally adequate. Specifically, studies performed for the cities of Los Angeles, San Francisco, Sacramento and Santa Cruz concluded that such degradation occurs no matter how well the excavation is restored.

The imposition of Trench Cut Fees has prompted legal challenges by at least two utility companies, who were successful at the federal district court level in invalidating the fee as a constitutional impingement on franchise agreements. These unfavorable rulings affected the cities of Santa Ana, San Francisco, Stockton and Union City.

At least one city (Sacramento) has successfully implemented a Trench Cut Fee without any legal challenges **whatsoever**. Sacramento's fee is based on a program of encouraging cooperation between the city and the utility companies to coordinate street cutting with street resurfacing efforts to minimize wear and save costs for both parties. If the city has planned to resurface a street segment within 2-3 years of the trench cut request, then the fee is waived, thus encouraging coordination. Sacramento also attempts to resurface streets only after the trench cuts are performed.

Due to the significant legal challenges that have occurred, further detailed analysis should be conducted before the Council considers this type of fee.

At this time, staff is researching a potential fee structure. The possible dollar recovery is currently unknown but estimated at a minimum of \$50,000 annually.

Rent for the SMaRT Station®

The Sunnyvale Materials Recovery and Transfer Station (SMaRT Station) is located on a parcel of land that is also occupied by the landfill. However, the land that the SMaRT Station actually sits on is not landfill. Records indicate that the land was originally purchased by the City with the intent of establishing a park.

Currently, the City's General Fund receives no revenue from the Solid Waste Management Fund's use of this land, even though the Solid Waste Fund receives a benefit for its use. Staff is exploring the possibility of charging rent to the Solid Waste Fund for the use of the land. Comparable land located on the top of the east hill of the landfill is currently rented by Raisch Concrete and Asphalt Recycling for approximately \$8 per square foot. Although more work needs to be done, staff estimates that the market rent is \$250,000 a year, and potentially higher.

Municipal Utility Infrastructure Fee

The City charges a franchise fee to the private utilities that operate in the City for the purposes of covering the impacts from the utility's operations on city infrastructure. This fee is also charged to the contractor that provides solid waste collection services for the Solid Waste Management Fund. The Department of Finance is exploring the possibility of adopting a similar fee that would apply to the other municipal utilities, specifically water and wastewater. Staff is proceeding slowly and carefully on this subject as there are many legal issues that have to be worked out prior to recommending any fee for adoption. It is anticipated that an analysis and recommendation will be completed within the next fiscal year.

The following table indicates potential revenue that the General Fund could realize from charging this type of fee to the Water and Wastewater utilities. Imposition of this type of fee would not require voter approval.

	Annual Operating Revenue	% Of Revenues			
		1%	2%	3%	4%
Wastewater	\$14,500,000	\$145,000	\$290,000	\$435,000	\$580,000
Water	\$16,800,000	\$168,000	\$336,000	\$504,000	\$672,000
	Total	\$313,000	\$626,000	\$939,000	1,252,000

REVIEW OF EXISTING TAXES

In order to fully assess the options available to increase, modify or enact new taxes, it is necessary to explain the distinction between locally assessed and collected revenues, and those revenues that are apportioned to us by governmental entities. As we only receive a small amount of revenue from the Federal government, the focus here is on revenues administered by the State and County (mainly on behalf of the State). The Sales and Use Tax, Property Tax and Vehicle License Fee are all examples of state-administered taxes, over which we have little control. In select cases, special legislative authorization can be obtained to seek increases in state-administered taxes. In fact, during the November 2002 elections the cities of Sebastopol and West Sacramento were successful in gaining majority votes with one-eighth and one-half cent sales tax increases respectively.

Outlined below is a list of existing taxes collected by the City. Included with each revenue is:

- A brief description of the tax, including information regarding date of adoption, the type of tax, who pays the tax, when the tax was last increased, etc.
- Information regarding our tax rates and structures and how they compare to other cities.
- Current revenue received and estimates of new revenue generation, where available.

In addition to the options presented here, it is important to note for the Council that staff has been actively reviewing the Municipal Code provisions governing these revenue sources to look for opportunities to *clarify* existing language wherever possible. This helps to protect the existing revenue base, ensure continued compliance, and provide additional protections from legal challenges, *all without triggering the voter approval requirements of Proposition 218*. Notable examples include the recent Utility Users Tax update to clarify what is taxable under the ordinance, and planned clarifications to the Transient Occupancy Tax.

Business License Tax

The Sunnyvale Business License Tax (BLT) was adopted by ordinance in 1968 and last increased in 1976. Though utilized by Sunnyvale as a general tax, it could be a special tax if designated for a specific purpose. Its tax structure remains one of the lowest in the area, and the tax generates approximately \$250,000 per year in revenue. The Sunnyvale

BLT is based on the number of employees or rental units (whichever is higher) and ranges from \$10-\$300 for businesses located in Sunnyvale and \$35-\$325 for businesses located outside of Sunnyvale. 80% of taxpayers fall into the lowest chargeable category (0-5 employees=\$10).

As previously stated, the ability to generate revenue from this source to pay for city services has been eroded over time. If the Sunnyvale BLT was doubled an additional \$250,000 in revenue would be generated. If the tax was tripled an additional \$500,000 in revenue would be generated.

Summary of Options to Consider:

- *Consider doubling the BLT to generate an additional \$250,000 in revenue.*
- *Consider tripling the BLT to generate an additional \$500,000 in revenue.*

Construction Tax

The Construction Tax is a general tax and was adopted by ordinance in 1975. It has never been increased and is assessed at the rate of 54% of one percent of the total valuation of all construction work for which a building permit is required. The Construction Tax covers all types of building construction except residential remodels. This tax varies significantly from city-to-city.

The Sunnyvale Construction Tax generates approximately \$1 million in revenue. If the tax was increased to one percent of the total valuation of all construction work for which a building permit is required, an additional \$900,000 would be generated.

Summary of Options to Consider:

- *Consider increasing the Construction Tax to 1% of total valuation to raise an additional \$900,000 in revenue.*
- *Consider expanding the base to include residential remodels to raise an additional \$75,000 in revenue.*

Transient Occupancy Tax

The Transient Occupancy Tax, or TOT, was adopted by ordinance in 1965 at the rate of 8% and became operative in 1968. The tax is assessed by hoteliers on behalf of the City on *transients* who occupy

lodging establishments for 30 days or less. Sunnyvale currently has 37 hotels operating within City limits, a handful of which provide long-term lodging not subject to the tax. Though the City's TOT revenue has dropped dramatically since the economic downturn began in 2001, it still is a major source of General Fund revenue, projected to be \$5.3 million by fiscal year-end.

The tax was last increased in 1995 to a rate of 8.5%. This increase was approved by Council to offset a projected revenue loss due to granting an exemption for governmental employees, with a proviso to raise the tax to 9% in 1996 if the revenue loss occurred. Neither the loss nor the increase materialized and the ability to raise the tax is now contingent upon voter approval.

In most cases (including Sunnyvale), the TOT is considered a general tax, although proceeds can be earmarked for specific purposes, thus creating a special tax. In the November 2002 elections, 12 out of 17 (70.6%) local governments were successful in obtaining majority approval to increase, extend, or enact a general TOT. Conversely, only 1 of 5 (17%) managed to obtain a 2/3 vote for a special TOT.

A recent survey indicated that Sunnyvale's TOT was the lowest of surrounding Bay Area cities. As the table below indicates, most cities in the area charge 10%, while Sunnyvale's rate is 8.5%.

City	TOT Rate
Santa Clara	9.5%
San Jose	10%
Mountain View	10%
Palo Alto	10%
Cupertino	10%
Milpitas	10%
Sunnyvale	8.5%

Increasing Sunnyvale's TOT to 10% would raise approximately \$900,000 in revenue at today's level. This amount should increase appreciably as the economy rebounds.

Staff is planning to update the TOT ordinance to provide clarification language that would enhance and protect current collections.

Summary of Options to Consider:

- Consider increasing the TOT to 10% to raise an additional \$900,000 in revenue.

Utility Users Tax

The Utility Users Tax (UUT) is a general tax adopted by ordinance in 1968, becoming operative in 1969 at a tax rate of 1%. In 1975 the tax was increased to 2%. The Sunnyvale UUT is applied to intrastate telephone, electricity and gas services. The UUT is a tax on the user of each utility, but it is collected by the utility companies and remitted to the City. The UUT currently accounts for more than 6% of General Fund revenues at about \$5.8 million.

In 1997 Sunnyvale voters approved Measures K and L, which were designed to gradually increase the UUT on electric service customers to 3% in response to anticipated revenue losses due to deregulation of the electric utilities industry and subsequent State requirements to decrease commercial and residential electric rates. The UUT for residential and small commercial customers was increased to 2.33% in 2000 and then decreased back to 2% in 2001 when electric rates went down. The UUT for large commercial customers was scheduled to increase to 3% in 2002, but this increase never occurred. Sunnyvale's UUT rate remains at 2%, well below the State average of 6%. The highest UUT currently assessed by a California city is 11%. 7 cities in Santa Clara County currently assess a UUT, with an average rate of 3.7%. Of the cities in the County that assess a UUT, Sunnyvale's is the lowest rate at 2%.

There are two options available to modify Sunnyvale's existing UUT ordinance: 1) increase the tax rate, or 2) broaden its base. By definition, the UUT may be imposed by a city on the *consumption* of utility services. These include, but are not limited to, electricity, gas, water, sewer, telephone (including cellular and long distance, or "interstate" service) sanitation and cable television. As Sunnyvale's UUT applies only to intrastate telephone, electricity and gas, the opportunity exists to not only increase the tax rate, but to broaden its base to other areas of coverage allowable under State law. Any of these changes would require voter approval, either a majority vote on a measure in conjunction with a general election of the City Council, or a 2/3 vote if the revenue is earmarked. An earmarked measure could be placed on the ballot at any election as a special election.

Though the UUT can be applied as a special tax, currently all UUT levies by California cities are for general taxes. Interestingly, there were 3 proposals on the March 2003 ballot to earmark UUT revenues for specific purposes – all failed.

The table on the next page summarizes the types of increases and/or modifications to the UUT that could raise additional revenue:

<u>Tax Measure</u>	<u>Voter Approval</u>	<u>Estimated Annual Revenue</u>	<u>Additional</u>
Increase UUT to 3% with current base	Majority		\$2,900,000
Increase UUT to County Average of 3.7% with current base	Majority		\$4,900,000
Broaden base at current 2% rate for:			
• Water	• Majority		• \$300,000
• Wastewater	• Majority		• \$275,000
• Solid Waste	• Majority		• \$470,000
• Cable TV	• Majority		• \$300,000
			Total=\$1,345,000
Broaden base to include Interstate Telephone Service	Majority		\$600,000- \$1,200,000

In 2001, Council approved updates to the UUT ordinance that did not require voter approval, specifically in the area of telecommunications. This type of clarifying language is essential to 1) ensure that companies are properly collecting and remitting the tax, 2) close potential loopholes that could lead to legal challenges, 3) ensure the ordinance remains up-to-date with changing technologies, and 4) preserve and protect the revenue stream.

Summary of Options to Consider:

- *Increase UUT rate to 3% at the current base.*
- *Increase UUT to County average of 3.7%, current base.*
- *Broaden Base of UUT to include one or more of the following: Water, Wastewater, Solid Waste, Cable TV, Interstate Telephone Service.*

POTENTIAL NEW TAXES

This section explores some of the options available to Council to place new ballot initiatives before the Sunnyvale voters, reviews various due dates for the upcoming elections in November 2003 and March 2004,

and discusses in greater detail the requirements necessary to enact and administer new taxes. The types of taxes discussed below all fall into the category of *special taxes*.

Special Taxes

Enactment of a special tax requires a 2/3 vote, and has a number of procedural requirements. The proceeds from special taxes must be earmarked for a specific purpose or governmental program, and as a result of laws enacted in 2000, also carry the following restrictions:

- Ballot measures for special taxes must include a statement indicating the specific purposes of the tax;
- The proceeds must be applied only to the specific purposes;
- The proceeds must be deposited into a separate account; and
- The local agency must prepare an annual report for its governing body to include the amount of funds collected and expended and the status of any project funded by the special tax.

The special tax may be levied on any reasonable basis determined by a city, including a flat per parcel rate, a rate equivalent to the cost of making facilities or authorized services available to each parcel, or a rate equivalent to the specific benefit received by the various parcels. The special tax may not be an ad-valorem property tax, e.g., levied as a percentage of assessed valuation. Note: A nexus to specific benefit is not a requirement, as this is a special tax and not a benefit assessment.

Special taxes can be implemented to finance a number of city services and can take the form of special taxes for police and fire services, paramedics, education, libraries, parks, open space and recreation, or for other services. Though there are many types of services for which special taxes can be enacted, the general application *and inclination by voters to approve* seems to trend toward public safety, education, library and parks and recreation services.

Parcel Taxes

A parcel tax is a type of special tax levied on parcels of property that can be used for any purpose. Use of the revenue is restricted to those services specified on the ballot measure. It is generally based on either a flat per parcel rate or a variable rate depending on the size, use and/or number of units on the parcel. Ordinances adopting parcel taxes

commonly provide that they are an excise tax based on the availability or use of municipal services and/or facilities. In response to the State budget crisis many school districts throughout the State (many in the Bay Area) have or will attempt to submit parcel taxes to the voters.

The table below provides an example of revenue estimates if a Sunnyvale parcel tax were enacted *based on a variable use rate for single family, multi-family and commercial/industrial property*. **The ratios provided in the table are for illustrative purposes only.** Of course, a complete analysis of the appropriate rate structure will be conducted if the Council wishes to pursue this type of tax measure.

Use	# of Parcels	Tax Per Parcel	Total Tax
Single Family	20,874	\$0.50	\$10,437
Multi-Unit	6,666	\$0.15	\$1,000
Commercial/ Industrial	1,373	\$1.00	\$1,373

Benefit Assessments & MELLO-Roos Community Facilities Tax⁵

There are two other options available to cities to levy assessments that are limited to special areas or pre-determined districts, which can encompass the entire boundaries of a city. Though the nature of the levy is different for each (one is considered an assessment and one is considered a tax), they are similar in that the levy inures to a defined geographical area or district.

Benefit Assessments

Benefit assessments are charges levied on real property to pay for public improvements or services in a defined district according to the special benefit each parcel received from the improvement or service. *Benefit assessments are neither taxes nor fees.* Rather, they are imposed as pay-as-you-go financing, or to provide bonded indebtedness for large capital construction projects. Several State statutes apply to different types of benefit assessment districts, and include the authority to create districts for landscaping or street lighting, fire services, and major street and sidewalk improvements. Within the defined districts, only the special benefits are assessable, and the property owners must take part in an assessment ballot. A majority vote of property owners (50%, plus 1) can defeat the assessment.

⁵ League of California Cities, Municipal Revenue Sources Handbook, 2001 Edition.

In Sunnyvale, an example of this currently in operation on a small scale is the Downtown Parking District, which levies an annual assessment for operation and maintenance costs of the downtown parking facilities.

Mello-Roos Community Facilities Tax

The Mello-Roos Community Facilities Act of 1982 allows cities to enact *special taxes through a 2/3 approval vote* to finance the purchase, construction, improvement, expansion or rehabilitation of public capital facilities and related services in connection with new development, with an estimated useful life of 5 years or more. This enabling law gives cities broad authority to utilize special taxes to provide services and improvements through the creation of Mello-Roos Community Facilities Districts. The district is a distinct entity of government, even though the governing body and the boundaries of the district may be the same as the cities’.

Authorized facilities can include park, recreation and open-space, school sites and buildings, libraries, childcare, street improvements and parking facilities. Services allowable under the Act include police and fire protection, hazardous materials cleanup, recreation programs, library, and operation and maintenance of parks, open-space, museums and other cultural programs.

Currently Sunnyvale has formed one Mello-Roos Community Facilities District – the CFD No. 1. This district was established with one property owner to finance a new parking structure at the Town Center Mall.

FEASIBILITY OF NEW TAXES

As Council begins to consider the potential for bringing tax measures to the voters, there are several key points concerning the relative voter palatability of new or increased taxes. This section discusses the feasibility of new tax measures by reviewing:

- Sunnyvale citizen preferences regarding tax and fee increases from historical and recent survey responses;
- Voter records of local tax measures from the November 2002 and March 2003 elections;
- Anticipated local tax proposals in the coming months.

Sunnyvale Resident Preferences

Previous Resident Satisfaction Surveys

Previous resident satisfaction surveys have included questions that provide additional insight into residents' preferences regarding potential tax or fee increases. The last three annual surveys included a question that asked residents whether they would prefer to see taxes increase or service cut if there was insufficient revenue to support current levels of service. Overall, residents prefer to increase taxes rather than reduce services, by a slim majority.

Question: "All local governments are receiving less state and federal funding these days. To make up for the shortage of funds, what action should the City take?"

	June 2000 Survey	December 2001 Survey	June 2002 Survey
Increase local taxes	58%	51%	53%
Keep taxes at current levels, but reduce the level of service provided	42%	49%	47%

April 2003 Resident Preference Survey

In early April 2003, the City contracted with the Gelfond Group to survey residents regarding potential service level reductions for 45 existing services. The key findings of the survey include:

- Residents prefer to maintain current service levels and raise fees, rather than reduce service levels.
- Few residents support either dropping or substantially reducing any City service.
- Most residents support raising fees, charges or local taxes in order to maintain service levels.
- Support for maintaining current service levels varies somewhat among demographic groups.
- Residents are confident that the City will wisely spend their local tax dollars.

Based on the results of the resident surveys conducted in the past three years, it would appear that residents support maintaining current levels

of service, would be willing to pay somewhat more in fees, charges and local taxes to keep current services levels, and are confident that local fees and taxes will be wisely spent.

Please see Attachment B for a copy of the Service Level Reductions Survey Results report that the Council received on April 25, 2003.

Voting Record of Recent Tax Measures

As the Council considers potential revenue-generating strategies, it will be helpful to survey the field to gauge the relative success or failure of recent local government ballot initiatives by reviewing efforts of local governments to extend, increase or enact new taxes. It will also be prudent to review information on anticipated local/regional measures in the coming months.

In the November 2002 elections cities, counties and special districts had a variety of tax measures with varying degrees of success. The types of tax proposals ranged from new levies to increases, modifications and extension to existing taxes. The **general tax** measures on the ballots numbered 27, mostly consisting of TOT and UUT proposals. 63% of the measures passed (17), while 37% failed (10). There were 79 **special tax** measures on ballots across the State, but these did not fare as well, with 46% passing (36) and 54% failing (43). The majority of the special tax proposals were special parcel taxes advanced by fire protection districts. This information was compiled by reviewing documents provided by the League of California Cities' special fiscal consultant.

In the March 2003 special elections, there were at least 18 tax proposals before the voters. One **general tax** passed: a UUT that alternatively increased the tax from 5% to 8% for businesses and decreased the residential rate from 5% to 4%. Of the **special tax** measures, 6 passed (35%) and 11 failed (65%). Interestingly, there were 3 UUT measures that earmarked the proceeds, triggering the 2/3 vote requirement; *all failed*. As previously anticipated in response to State budget cuts to schools, 9 school districts proposed ballot measures, consisting of 4 bond issues (1 pass, 3 fail) and 5 parcel taxes (3 pass, 2 fail). This information was compiled from various sources and may not encompass the entire list of March 2003 ballot measures.

Anticipated Tax Measures

Given the depth of the State's proposed budget cuts to education, there are no less than 11 school districts in the Bay Area that plan to place parcel taxes on the June 2003 ballot. Staff is not aware of any tax measures currently anticipated for school districts serving Sunnyvale.

In addition, several Bay Area cities will likely attempt to enact new taxes or increase existing taxes in the not so distant future. For example, the City of Fremont has indicated it may pursue either of the following: consider increases to the paramedic tax or TOT, or proposing a new public safety parcel tax or a UUT. It is unknown at this time when Fremont will advance its proposal(s) to the voters.

TIMETABLES FOR TAX MEASURES

Should Council wish to pursue increasing existing taxes or enacting new taxes, there are a number of procedural requirements set in State law and by City Charter that specify timetables (among other things) for *general and special* elections held in Santa Clara County. It is important to note that, should Council wish to pursue increases or modifications to any existing general taxes, the opportunities to do so are restricted to November elections in odd-numbered years. This means that November 2003 is the City’s only opportunity to place a general tax measure before the voters until November 2005.

As Council is aware, the next general municipal election will be held on November 4, 2003. The due date for tax measure resolutions and tax rate statements is Friday, August 8, 2003. The election must be called for prior to this date. Arguments for and against measures are due August 13, 2003. Below is an abbreviated version of the County Registrar’s election calendar for the November general elections.

November 4, 2003 General Municipal Election – Key Filing Dates	
Dates	Activities/Documents
August 8, 2003	Due date to file resolution calling for tax measure election, and if applicable, tax rate statements.
August 13, 2003	Deadline for submitting arguments in favor of and against tax measures.
August 20, 2003	Deadline for submitting rebuttals to arguments in favor of and against, and the impartial analysis.

If Council chooses to consider a special tax measure, this can be scheduled at any general or special election. Below are estimated dates for the March 2004 special election.

March 2, 2004 Special Municipal Election – Key Filing Dates⁶	
Dates	Activities/Documents
December 5, 2003	Due date to file resolution calling for tax measure election, and if applicable, tax rate statements.

⁶ Estimated 2004 due dates based on 2003 calendar.

December 11, 2003	Deadline for submitting arguments in favor of and against tax measures.
December 18, 2003	Deadline for submitting rebuttals to arguments in favor of and against, and the impartial analysis.

To the extent Council wishes to pursue tax measures on the November 2003 ballot, two important points should be considered. First, the Sunnyvale General Municipal Election must be consolidated, by Charter, with Foothill-DeAnza Community College District, Sunnyvale School District and Cupertino Union School District. Second, detailed analyses and public outreach will need to be completed and considered prior to any tax increase proposal.

Though there are a significant number of substantive and procedural requirements involved in enacting new taxes, only the major points are covered here. To the extent Council wishes to pursue any potential tax increases, a complete list of requirements will be analyzed and presented at that time.

ANTICIPATED OR PENDING STATE LEGISLATION

Two bills are pending in the State Legislature that could ultimately bring additional revenue to local governments, or make it less onerous for cities to enact certain types of taxes that could be used for ongoing operating costs. It should be stressed that many hurdles remain, and even if passed, it could be several years before Sunnyvale could actually reap a benefit. Still other ideas are circulating that could ultimately be proposed as legislation. Each bill, whether in committee or anticipated, will be discussed by the type of tax likely or potentially generated by its adoption.

Local Income Tax – AB 1690 (Leno)

On April 9, 2003, the Assembly Local Government Committee approved by a 6-2 vote legislation that would enable cities and counties to pursue local income taxes, with half of the revenue dedicated to public safety services. This proposed legislation will now be heard in the Assembly Appropriations Committee. The measure is sponsored by firefighter and law enforcement unions, who have portrayed the bill as “an important safety net” for local safety services. The legislation would allow a city or county to seek majority approval to enact the tax. If approved by the voters, cities would have the opportunity to collect a local income tax up to 8% of the State tax liability (2% for counties). For example, if a person’s state tax liability was \$1,000, then a city could collect up to 8%

of that amount, or \$80. Opponents of the measure argue that the State Constitution requires a 2/3 vote to enact this type of special tax.

Constitutional Amendment for Special Public Safety Tax Approval – ACA 15 (Wiggins)

This measure would provide an exception to the local 2/3 vote requirement for special taxes mandated by Proposition 13 by allowing a majority vote for taxes earmarked for public safety services. The proposal will likely be heard in committee during early May.

INFORMATION AND PUBLIC PARTICIPATION

Potential Ad Hoc, Advisory Committee on Local Tax Issues

This report describes three types of potential enhancements to revenue sources that the City uses or could use in order to deliver services at established levels of service. The City Council has taken extraordinary steps to provide information about the 6-Point Plan and the budget strategies to residents and business groups. Council has also provided several opportunities for residents and business leaders to comment and offer suggestions regarding the budget strategies as they are being considered by the City Council. It may be especially appropriate to create an additional opportunity for public comment on potential increases to existing taxes or establishing new local taxes by creating a special ad hoc advisory committee.

Other cities and counties across the country have created task forces or advisory committees to assist local elected officials as they consider establishing potential new revenue sources. Sunnyvale has also used this practice in the past to examine a specific issue. Ad hoc committees have been formed to examine potential City Charter revisions, rent control, and the quality of life index project. The most recent example of an ad hoc committee was the downtown stakeholders group, which provided the City Council with valuable information and insights as it considered the downtown design plan.

A three-part assignment or scope of responsibility could be given to the ad hoc advisory committee:

1. Examine further the potential for increasing existing local taxes or establishing new local taxes. This would include the following local taxes:

Existing Taxes

- Business License Tax

- Construction Tax
- Transient Occupancy Tax
- Utility Users Tax

New Taxes

- Special Taxes
- Parcel Taxes
- Benefit Assessments
- Mello-Roos Community Facilities Tax.

This further examination would address questions and issues raised by Council members as they considered this report and provide preliminary policy guidance to City staff.

2. Recommend a package of increases to existing taxes and/or the establishment of new taxes for consideration by the City Council. This recommendation should include a suggested timetable for voter action on those increases to existing taxes and/or the establishment of new taxes that require voter approval.
3. Develop a recommended public information campaign that can be used to inform and educate Sunnyvale residents about any proposed increases to existing taxes or new local taxes that the City Council decides to take to the voters. This campaign would be designed to help voters make informed decisions if tax related issues were placed on future ballots. The campaign would not be designed or structured to advocate a certain position on any one tax related issue or the overall need to raise or establish new taxes in light of the City's budget crisis.

The ad hoc advisory committee would need to be established as soon as possible in order to complete its assignment. As stated earlier, there is an August 8, 2003 deadline in order to file a resolution calling for a tax measure election as part of the November 4, 2003 general municipal election. If Council decides to use an ad hoc advisory committee, it is suggested that the following schedule be created:

- May 6, 2003: Council determines need for an ad hoc advisory committee on tax issues.
- May 13, 2003: Council appoints committee membership.
- July 1, 2003: Committee completes its written recommendation on potential tax issues, and distributes it to Council.
- July 15, 2003: Committee presents its recommendation to Council.

Council could take final action on the committee's recommendation at its July 15th regular meeting, or at a special meeting to be scheduled so that any required resolution could be prepared.

It is important that the membership of the ad hoc advisory committee is representative of the community. Increases to existing taxes and/or new local taxes will affect residents, property owners, businesses, and community groups. It is suggested that each Councilmember appoint two members, one a representative of a business located in Sunnyvale and the second a registered voter and Sunnyvale resident. A total of three Council members could serve on the committee. This would constitute a committee of 17 members. The Council as a whole could select the committee chairperson. All committee members would have voting status. The Finance Department and Office of the City Manager would staff the committee.

May 6, 2003 Regular City Council Meeting

The City Council has the overall, primary role in setting policy regarding increases to existing taxes and/or establishing new local taxes. City staff's role is to provide data and information, and to provide recommendations, to support the Council in determining policy. Through this report, the City Manager is providing staff's recommendations regarding changes to fees, charges, and local taxes. The report also provides data and information regarding residents' preference regarding service reductions and tax/fee increases.

Council will have the first of several opportunities at the May 6, 2003 regular meeting to provide preliminary guidance on fee and tax related issues.

The Council can also provide policy direction on tax issues at the May 20, 2003 workshop on the proposed FY 2003/2004 budget and at the June 3, 2003 public hearing on the proposed budget. Final policy direction will be provided when the Council adopts next fiscal year's budget; this action is scheduled for Council's regular meeting on June 17, 2003.

Community Budget Meetings

It's important that the public is kept informed and is provided opportunities to participate as the City addresses this budget crisis. As you know, a special link on the City's web page has been established to provide the public with easy access to written reports, such as this one, that addresses the budget crisis. In addition, a series of community

meetings have been held so that Council can gather public input into the various budget strategies and courses of action that are being recommended to solve the gap between revenues and expenses in the General Fund. Two community meetings have been scheduled for the public to comment on tax-related issues. They are:

- May 8, 2003, 7:00 pm, at Fremont High School
- May 13, 2003, 10:00 am, at the Columbia Neighborhood Center, Multipurpose Room.

In addition, the public will be able to provide comments, ideas, and suggestions regarding the potential increases to existing or proposed new fees, charges, and local taxes at the May 6th City Council meeting, and on the overall proposed budget for next fiscal year during public hearings at the June 3rd and June 17th regular meetings.

RECOMMENDATIONS

1. Direct staff to continue research on the following potential new fees and charges:
 - Emergency 911 Fee
 - Homeowner Sidewalk Repair Fee
 - Trench Cut Fee
 - Rent for SMaRT Station
 - Municipal Utility Infrastructure Fee

Potential new fees and charges will be presented to the City Council by January 1, 2004, for final action and implementation as directed.

2. Approve in concept changes to the following existing fees and charges, and proposed new fees and charges to be included in the recommended Fee Schedule for FY 2003/2004:
 - Business License Processing Fee
 - Community Planning Fee – General Plan Maintenance
 - DVD/Video Rentals at Library
 - False Fire Alarm Fee

These revenue enhancements will be considered for final approval by the City Council when it adopts the Fee Schedule for FY 2003/2004.

3. Authorize staff to establish a 17 member ad hoc advisory committee on local tax issues. The committee's charge is to examine the potential for increasing existing local taxes or establishing new local taxes, to recommend to the City Council a package of increases to existing taxes and/or new taxes by July 1, 2003, and to develop a recommended public information campaign to inform and educate Sunnyvale residents about any proposed increases to existing taxes or new local taxes. It is further recommended that each Council member appoint two committee members, one a representative of a business located in Sunnyvale and the second a registered voter and Sunnyvale resident. Three Council members would serve on the committee, with the Council selecting the committee chair.